



## BUSINESS LAW SECTION

THE STATE BAR OF CALIFORNIA

### LEGISLATIVE PROPOSAL (BLS-2008-06) *RENEWABILITY OF LIENS*

**To:** Larry Doyle, State Bar Office of Governmental Affairs

**From:** Mark Porter, Chair, Insolvency Committee, Business Law Section

**Date:** July 31, 2007

**Re:** Proposed Amendments to C.C.P. §697.510 to enable liens filed with the California Secretary of State to be renewed every five years

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#### SECTION ACTION AND CONTACTS

Date of Approval by Legislative Subcommittee of the Section Executive Committee: July 31, 2007

Approval vote: For: 4 Against: 0

Date of Approval by Insolvency Law Committee: May 4, 2007

Approval Vote: For: 20 Against: 0

Executive Committee Contact	
Name:	Keith Bishop, Esq.
Address	Buchalter, Nemer, a professional corporation 18400 Von Karman Ave #800 Irvine, CA 92612
Phone:	949-224-6293
Fax:	949-224-6228
E-mail:	kbishop@buchalter.com

Standing Committee Contacts	
Name:	Molly J. Baier
Address	Wells Fargo Bank, N. A. Legal Department 633 Folsom Street – 7 <sup>th</sup> Floor MAC A0149-073
Phone:	415/396-3723
Fax:	415/975-7863
E-mail:	baiermj@wellsfargo.com
Name:	Robert Harris
Address:	Binder & Malter, LLP 2775 Park Avenue Santa Clara, California 95050
Phone:	408-295-1700
Fax:	408-295-1531
E-Mail:	rob@bindermalter.com

**PURPOSE:** To enable judgment liens filed with the California Secretary of State to be renewed every five years, just as financing statements can be renewed.

**DIGEST:** §697.510 of the Code of Civil Procedure currently permits a judgment creditor to record a judgment with the California Secretary of State to create a lien on certain personal property assets of the judgment debtor which lasts for five years. However, the law currently does not permit the judgment lien to be continued through the filing of a continuation statement, resulting in a loss of priority at the end of five years. This proposal would change the law to permit continuation of the lien for successive five-year periods in the same manner as a voluntary lien.

**BACKGROUND:** Division 9 of the California Uniform Commercial Code provides a system for establishing the priority of liens on many types of personal property through the filing of a financing statement with the California Secretary of State. California Commercial Code §9322(a) provides that, as between conflicting security interests perfected by filing a financing statement, priority ranks according to priority in time of filing the financing statement. Through this system, lenders can safely provide financing secured by the personal property of their borrowers: the lender is assured of the priority of its lien even while the personal property remains in productive use in the hands of the borrower. California Commercial Code §9515(a) provides for a filed financing statement to be effective initially for only five years, but under §9515(d) the financing arrangement can continue indefinitely as long as a continuation statement is filed within six months before the date the financing statement would otherwise expire. The filing of the continuation statement allows the secured party to maintain its priority against later filed financing statements.

California Code of Civil Procedure §697.510 provides a similar mechanism for a judgment creditor to establish a lien on certain personal property assets of the judgment debtor and be accorded priority in the same recording system of record, thereby giving notice of the lien to other creditors while the personal property remains in productive use in the hands of the judgment debtor. The lien attaches to accounts receivable, chattel paper, equipment, farm products, inventory and negotiable documents of title. See Cal. Civ. Proc. Code §§697.510(a) and 697.530(a).

This provision creates a useful alternative to the immediate levy and seizure of a judgment debtor's assets under a writ of execution. For example, the debtor may own a manufacturing facility containing specialized equipment that can create valuable products over a long lifespan. In the case of a large judgment against a small company, it may be in the best interests of all concerned – judgment debtor, judgment creditor, other creditors, employees, suppliers, landlord, etc. – for the judgment debtor and judgment creditor to agree to a payment plan lasting many years.

Unfortunately, unlike the California Commercial Code, the Code of Civil Procedure does not permit a judgment lien on personal property to be renewed every five years. Rather, it requires the judgment creditor to file a new notice of judgment lien that does not relate back to the earlier filed judgment lien, causing a judgment creditor to step to the back of the priority queue if it

wishes to continue the judgment lien at the end of five years. California Code of Civil Procedure §697.510 provides:

(a) A judgment lien on personal property described in Section 697.530 is created by filing a notice of judgment lien in the office of the Secretary of State pursuant to this article.

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(b) Unless the money judgment is satisfied or the judgment lien is terminated or released, the judgment lien continues for five years from the date of filing.

(c) *Notwithstanding Section 697.020, the priority of a judgment lien created under this article does not relate back to the date an earlier judgment lien was created under this article.*

Cal. Civ. Proc. Code §697.510, (*emphasis added*).

This creates a scenario in which, regardless of the underlying economics, a judgment creditor may be forced to dismantle a going concern in order to squeeze whatever value can be had from the assets while they are still subject to the lien in order to maintain its priority in distribution of proceeds.

Amending the statute to permit the judgment lien to be continued at the end of the initial five-year period would open the opportunity for the judgment creditor and judgment debtor to enter into a long term payment plan that may permit a research and development program to come full circle, or a newly planted orchard to grow to maturity and bear fruit, or a machine with a thirty-year lifespan to continue to produce widgets rather than going to the auction block.

The proposed amendments will bring the legislation with respect to judgment liens on personal property into closer alignment with the way judgment lien on real property are treated under California law. A judgment lien on real property initially lasts for ten years from the date of entry of the judgment (See Cal.Civ.Proc.Code §697.310) and may be extended for additional ten-year periods by renewing the money judgment (See Cal.Civ.Proc.Code §683.180).

**LEGISLATIVE HISTORY:** It appears that the five year limitation was intentional when the statute was originally enacted in 1982. The California Law Revision Commission Report states:

Subdivision (b) makes the duration of the judgment lien on personal property the same as the effective period of a filed financing statement under Commercial Code Section 9403(2).<sup>a</sup> Unlike a security interest, however, the judgment lien on personal property may not be extended beyond the five-year period. The five-year period is sufficient to permit the judgment creditor to apply the property to the satisfaction of the judgment by execution or otherwise. If the judgment creditor files a second notice of judgment lien on the same property, the second filing does not affect the first lien nor extend the five-year period of its duration. Subdivision (c) makes clear that the priority and duration of

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<sup>a</sup> Division 9 of the Uniform Commercial Code underwent a major revision in 1999, effective July 1, 2001, resulting in a renumbering of section 9403 as 9515.

the second lien is based on its date of filing and does not relate back to the date of the filing of the notice of the first lien. However, if a judgment lien is created under this article, it may relate back to an earlier attachment lien. See Section 697.020 and the Comment thereto.

16 Cal.L.Rev.Comm. Reports 1290 (1982).

The sole rationale given by the Law Revision Commission for limiting the effectiveness of the judgment lien to five years – that five years is deemed “sufficient” to permit the judgment creditor to apply the property to the satisfaction of the judgment by execution or otherwise – does not appear to take into account the sometimes significant difference between liquidation value and the value that may be produced over time by a going concern.

#### **DOCUMENTATION:**

We are not aware of any studies, reports or statistics with respect to these statutes.

#### **HISTORY:**

We are not aware of any similar proposals considered by the State Bar or the Legislature.

#### **PENDING LITIGATION:**

We are not aware of any pending litigation that would be affected by this proposal.

#### **LIKELY SUPPORT AND OPPOSITION:**

This proposal is likely to be supported by both judgment creditors and judgment debtors, as it will give both parties the flexibility to enter into a payment plan that will be beneficial to both parties. We are not aware of any likely opposition.

#### **FISCAL IMPACT**

Unknown but likely to be minor. There may be nominal start-up costs for the Secretary of State’s office to review the new legislation and incorporate its mandates into the business process (including staff training, determining whether a new filing form is needed or whether the existing forms require modification, and perhaps modifying software to accept the new or modified form(s)). These costs are likely to be offset by the user fees provided for in proposed Section 697.510(k).

### **TEXT OF PROPOSAL**

SECTION 1. Section 697.510 of the Code of Civil Procedure is amended to read:

(a) A judgment lien on personal property described in Section 697.530 is created by filing a notice of judgment lien in the office of the Secretary of State pursuant to this article. A judgment lien may be created under this article only if the judgment is a money judgment that was first entered in this state after June 30, 1983. Except as provided in subdivision (b) of Section 697.540, a judgment lien may not be created under this article if the money judgment is payable in installments unless all of the installments under the judgment have become due and payable at the time the notice of judgment lien is filed.

(b) ~~Unless the money judgment is satisfied or the judgment lien is terminated or released~~ *Except as otherwise provided in subdivisions (c), (e) or (g), the judgment lien continues for five years from the date of filing.*

(c) ~~Notwithstanding Section 697.020, the priority of a judgment lien created under this article does not relate back to the date an earlier judgment lien was created under this article. The effectiveness of a filed judgment lien lapses on the expiration of the period described in subdivision (b) unless before the lapse a continuation statement is filed pursuant to subdivision (d). Upon lapse, the judgment lien created by the filing of a notice pursuant to subdivision (a) ceases to be effective.~~

(d) *A continuation statement may be filed only within six months before the expiration of the five-year period specified in subdivision (b).*

(e) *A continuation statement that is not filed within the six-month period prescribed by subdivision (d) is ineffective. Upon timely filing of a continuation statement, the effectiveness of the initial notice of judgment lien continues for a period of five years commencing on the day on which the notice of judgment lien would have become ineffective in the absence of the filing. Upon the expiration of the five-year period, the notice of judgment lien lapses in the same manner as provided in subdivision (c), unless, before the lapse, another continuation statement is filed pursuant to subdivision (d). Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial notice of judgment lien.*

(f) *For purposes of this section, "continuation statement" means an amendment of a notice of judgment lien which does both of the following:*

- (1) *Identifies, by its file number, the initial notice of judgment lien to which it relates.*
- (2) *Indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the identified notice of judgment lien.*

(g) *Notwithstanding any other provision of this section, the lien created by this section is extinguished at the earliest to occur of the following: (i) the money judgment is satisfied, (ii) the period of enforceability of the judgment, including any extension thereof pursuant to Division 1, Chapter 3, Article 2 of this title (commencing with Section 683.110), terminates, or (iii) the judgment lien is terminated or released. If the lien created by this section is extinguished, the judgment creditor shall file a statement of release within 20 days after the judgment creditor receives an authenticated demand from the judgment debtor.*

(h) *If the judgment creditor does not file a statement of release pursuant to subdivision (g), the person who made the demand may apply to the court on noticed motion for an order releasing the judgment lien. Notice of motion shall be served on the judgment creditor. Service shall be made personally or by mail. Upon presentation of evidence to the satisfaction of the court that the period of enforceability of the judgment has terminated, the court shall order the judgment creditor to prepare and file the statement of release or shall itself order the release of the judgment lien. The court order may be filed in the office of the Secretary of State with the same effect as the statement of release demanded under subdivision (g).*

*(i) The court shall award reasonable attorney's fees to the prevailing party in any action or proceeding maintained pursuant to this section.*

*(j) The damages provided by this section are not in derogation of any other damages or penalties to which an aggrieved person may be entitled by law.*

*(k) The fees for filing and indexing a record under this section, or for responding to a request for information from the filing office, are as set forth in Section 9525 of the Commercial Code.*

*(l) The provisions of Sections 9522 and 9523 of the Commercial Code shall apply to a notice of judgment lien to the same extent as to a filed financing statement.*

*(m) Terms for which definitions are not set forth in Division 1, Chapter 1 of this Title (commencing with Section 680.120) have the definitions set forth in the Commercial Code.*

SEC. 2. Section 697.670 of the Code of Civil Procedure is amended to read:

(a) The Secretary of State may prescribe, provided that a cost savings would be achieved thereby:

(1) The forms for the notice of judgment lien on personal property and the statement of *continuation*, release or subordination provided for in this article.

(2) The form for the statement provided for in Section 697.640 and the situations when that form is required or is not required.

(b) A form prescribed by the Secretary of State for a notice or statement pursuant to subdivision (a) is deemed to comply with this article and supersedes any requirements specified in this article for the notice or statement.